a

2018

Santa Clara Valley Water District

DISTRICT WIDE AUDIT RISK ASSESSMENT

FINAL REPORT: SEPTEMBER 2018

TAP INTERNATIONAL, INC. CALIFORNIA, UTAH, AND WASHINGTON D. C.

Transmittal Letter

TAPInternational

Date: September 12, 2018
To: Board Audit Committee
From: TAP International, Independent Auditor
Subject: Districtwide Risk Assessment

The Santa Clara Valley Water District (District) is the largest multi-purpose water supply, watershed stewardship and flood management special district in California, covering 1,300 square miles of the Silicon Valley. The District, governed by seven elected Board of Directors to oversee the management of the District, is responsible for ensuring a safe, reliable water supply, reducing toxins, hazards, and contaminants in waterways, protecting water supplies from natural disasters, restoring wildlife habitat, and providing flood protection.

The District engaged TAP International to conduct a District-wide risk assessment of operations for FY 2017-18. Generally Accepted Government Auditing Standards suggest use of a risk assessment to prioritize limited financial resources on areas that need immediate attention.

The results of the risk assessment are used to assist in the development of an Annual Audit Work Plan. The Annual Audit Work Plan also includes the audit suggestions of individual Board members and District staff. The Annual Audit Work Plan will be prepared under separate cover.

Risks, from an audit perspective, represent improvement opportunities that could result from active monitoring or from audits. The identification of risk areas does not necessarily indicate that a problem is currently present. All public agencies have risk that could be inherent or be specific risks. An example of inherent risk is managing a multi-million capital construction program. The magnitude of the District's financial investment into capital projects is the leading cause of the inherent risk. One example of a specific risk is repeated cost overruns on capital construction projects.

The risk assessment was based on interviews and reviews of reports, plans, budgets, and other District-generated information. Staff interviews were conducted at the executive and mid-management levels across 13 offices, divisions, and units, focusing on 14 operational areas selected by the Board of Directors. Any high-risk area will be addressed in the Annual Audit Work Plan.

TAP International thanks the 32 District employees who participated in this assessment.

TAP International, Inc.

Table of Contents

Contents

RESULTS IN BRIEF 1

Introduction 1

Risk Summary 1

Conclusions 2

RECOMMENDATIONS: 2

PRINCIPAL RESULTS 5

Operational Activity Areas that have Low Need for Audits 5

Operational Activity Areas with High Need of Audits 6

Operational Areas with Moderate Need of Audits or District Monitoring 7

APPENDIX A: METHODOLOGY 12

APPENDIX B: HEAT MAP - DISTRICT WIDE 15

APPENDIX C: HEAT MAPS - Low Audit Risk Areas 16

APPENDIX D: HEAT MAPS – Moderate Audit Risk Areas 18

APPENDIX E: HEAT MAPS – High Audit Risk Areas 22

RESULTS IN BRIEF

Introduction

A primary purpose of the Santa Clara Valley Water District (District) Board Audit Committee (BAC) is to advance open and accountable government through accurate, independent, and objective audits that seek to improve the economy, efficiency, and effectiveness of District operations. To support the oversight and monitoring role of the BAC and of the Board, the District Board established an independent auditor function in 2017. TAP International, Inc. serves as the current independent auditor. To initiate the audit planning function of the independent auditor, professional auditing standards urge the use of a risk-based approach in prioritizing audits. The results of the risk assessment serve as one mechanism to develop an annual audit plan. Other mechanisms include input from the Board of Directors, District management and staff.

When conducting a risk assessment for auditing purposes, risk is measured by the likelihood of a problem occurring and the expected impact of the risk should it materialize. Risk areas represent potential opportunities to conduct audits that will provide objective analysis and recommendations to improve performance, reduce costs, and strengthen public accountability. Examples of audit objectives may include but are not limited to:

- Determining the cost-effectiveness of a program or activity.
- Evaluating how an organization can improve its procurement and contracting activities.
- Assessing the reliability, validity or relevancy of performance measures related to project effectiveness, results, economy, or efficiency.

Using information collected from 13 District office, divisions, and units, hereafter referred to as entities, TAP International assessed the need for an audit across 14 operational activities.

Risk Summary

As shown in Figure 1, there are low needs for audits in three of 14 operational activities—Personnel Safety, Strategic Goals and Objectives, and Environmental Sustainability. These areas will not likely benefit from an audit because current activities sufficiently mitigate inherent and specific risks. For example, in the area of Personnel Safety, the District implements adequate administration, management and employee training activities that reduce the risk of employee injury. When injuries do occur, the District responds effectively to prevent their re-occurrence.

Figure 1. Operational Areas with Lower Audit Need

As shown in Figure 2, there are four areas with high need for audits. These areas are: Procurement and Contracts, Contract Change Order Management, Succession Planning, and Fraud Prevention. For example, procurement and contracting processes are not implemented based upon risk management principles, which subjects all contracts to a lengthy review process that may not always be warranted. A high-risk score does not mean that an activity is being managed ineffectively or indicate whether adequate internal controls are in place that function as intended. Instead, a high-risk score means that factors are present, inherent, or specific, that warrant an audit to ensure Board priorities of project and service delivery as well as operational effectiveness are met.

Figure 2. Operational Areas with High Audit Need

As shown in Figure 3, the District should monitor activities in seven areas. These areas include: (1) Business Continuity, (2) Capital Planning and Management, (3) Financial Management; (4) EEO/Diversity, (5) Performance Management, (6) Internal Controls, and (7) Transparency. The District's current activities in these areas are sufficient to the extent that an audit is not immediately needed, but District monitoring is needed to help avoid future problems. Monitoring activities can include the review of reports submitted to the Board of Directors, spot checks of transaction activities, review of project outcomes, or short assessments of management actions, staffing changes, or short limited audits of newly discovered issues and concerns.

Figure 3. Operational Areas that Need Monitoring

Conclusions

Implementation of a risk assessment serves as one mechanism to support the development of an annual audit work program. Areas of high risk and moderate risk could be addressed in the audit work program or the District's Chief Executive Officer can address them internally. The BAC provides final review and approval of the audits to be included or not included in the Annual Audit Work Plan.

RECOMMENDATIONS:

1. The BAC should consider including audits in the Annual Audit Work Plan that address the following areas:

a. Contract management and purchasing
b. Contract change order management
c. Capital project cost estimating
d. Workforce planning

2. The BAC and District Board of Directors should direct the District's CEO to actively monitor the following areas for continued improvement. These areas include:

Business Continuity
- Business impact analysis

Financial Management
- Accounts payable administration
- Financial administration
- Payroll tax liability reporting
- Financial performance effectiveness

Performance Management
- Budget analytics

Internal Controls:
- Control activities
- Control environment
- Information and communication
- Monitoring

Transparency:
- Information sharing

3. The District CEO should act to implement the following recommendations to mitigate risks.
   a. To ensure accurate financial reporting, the District, in the next system financial system upgrade, should restrict employees from entering unauthorized project codes and develop system work flows to ensure supervisors acknowledge and attest to the accuracy of the payroll timesheets.
   b. To ensure operating effectiveness, assign responsibility to complete the District's business continuity plan; test the plan to ensure its effectiveness and check the working condition of incident response equipment.
   c. To prevent potential fraud, waste, and abuse, establish and implement a fraud prevention program that includes (a) delegated responsibility for education and training activities, (b) the implementation of a fraud reporting system, and (c) the development of policies and procedures for investigating fraud reports.
   d. To better assess operating effectiveness, develop and compute meaningful performance measures, such as, the number of contracts over budget, average cost overruns, costs to administer accounts payable processing, and cost to administer

procurement and contract review from issuance of requests for proposals to contract execution.

e. To enhance succession planning activities, perform a District-wide workforce planning study, and develop a District-wide succession plan.
f. To ensure prompt recovery of operations due to disruption, finalize and test the District's business continuity plan.

PRINCIPAL RESULTS

Operational Activity Areas that have Low Need for Audits

Personnel Safety

Personnel Safety Activity Areas	Likelihood*	Impact**
Employee Participation	Low	Low
Safety Governance	Low	Low
Safety Management	Low	Moderate

*The level of need for an audit.
**Impact (if an audit was conducted, the level of impact on Board priorities on service delivery, project delivery, or overall effectiveness)

The risk assessment examined three personnel safety activities—employee participation, safety governance, and safety management. District-wide, this operational area showed the least potential for concern that an audit is needed. District staff across all the departments that participated in the assessment provided positive information about the training and response efforts by Personnel Safety. When incidents do occur, the unit responds promptly. Our review of Occupational Safety Health Administration (OSHA) records show the last major incident occurred in 2007 that led to a fine imposed on the District.

Strategic Goals and Objectives

Strategic Goals and Objectives Activity Areas	Likelihood	Impact
Goal Setting	Low	Moderate

The risk assessment examined strategic goal setting and activities, such as whether the entity's goals reflect the District's highest priorities, how the goals were established, and assignment of goal owners. Risk assessment results showed low level of concerns for audits in this area. The District sets priorities, focuses energy and resources on goal setting, and ensures that employees and other stakeholders are working toward common goals. However, since the District has not yet formalized or documented a District-wide strategic plan, there is moderate risk that problems could impact operations across multiple departments.

Environmental Sustainability

Environmental Sustainability Activity Areas	Likelihood	Impact
Green Building	Low	Moderate
Water and Wastewater	Moderate	High

The risk assessment examined District activities to facilitate green initiatives and implement technology to reduce the District's carbon footprint with water and wastewater operations. District employees raised concerns about the District's decentralization of environmental stewardship and how the District plans to respond to the increasing challenge of complying with environmental regulations within the State. While these structural and governance risks were noted, there were

not enough gaps in District activities to raise overall risk levels. While there is not an immediate need for audit, District monitoring is needed of its environmental sustainability activities.

Operational Activity Areas with High Need of Audits

Purchasing/Contracting

Purchasing/Contracting Activity Areas	Likelihood	Impact
Contract Management	High	High
Purchasing	High	High

The risk assessment examined contract management and purchases activities. Both activity areas have high need for audits. Concerns include:

- The use of an outdated and District-built information system to track and monitor contracts.
- The long length of time needed by District Counsel to review contracts when suggested revisions are grammar related.
- The absence of effective training in developing requests for proposals and contracts .The District, with the hiring of an Interim Chief Operating Officer for Administrative Services, implemented extensive training on writing contracts, implementing the request for proposal process, and contract negotiations in 2017 and 2018 and plans to offer continued training to District staff in the future. The impact of this training on proposal preparation and contract processing will need to be monitored by the District.
- The absence of applying key principles of risk management. Many Requests for Proposals and contracts are subject to the same lengthy processes when some types of work do not present a high risk to District.
- The absence of updated purchasing forms, templates, and other tools to govern the processes.

While the District has developed plans to implement improvements, service delivery and operating effectiveness, risks will remain without more detailed and comprehensive performance audits.

Succession planning

Succession Planning Activity Area	Likelihood	Impact
Succession Planning	High	High

The risk assessment examined succession planning activities, such as identification of critical skill sets, identification and professional development of emerging leaders, and development of comprehensive standard operating procedures. While the Human Resources Department has provided training on succession planning activities, many divisions and units have not continued initial efforts to implement formal succession planning efforts, generally reacting to immediate workforce planning needs versus proactive planning. Department officials said the District internship program is an excellent resource to hire new and qualified talent, but the length of time for positions to become available in some District divisions has hampered succession planning

efforts. In addition, District managers reported that priorities for emerging leader training program compete with other higher priorities of the District.

Contract Change Order Processing

Change Order Processing Activity Area	Likelihood	Impact
Change Order Management	High	High

The risk assessment examined change order management activities because the financial value of the District's change orders can total up to 10 percent of the contract's original value. For multi-million-dollar capital improvement projects, the added costs are significant. The procedures, forms and templates used throughout the District to process change orders to contracts varies. Some divisions follow robust procedures and others do not. Audits in this area can further examine business processes to develop solutions that mitigate District risks.

Fraud Prevention

Fraud Prevention Activity Areas	Likelihood	Impact
Fraud Detection	High	High
Fraud Governance	Moderate	High
Fraud Prevention	High	High

The risk assessment examined fraud detection, fraud governance, and fraud prevention. A government best practice is to have a formal fraud prevention program in place. A fraud program clearly assigns responsibility of key staff members for their implementation, and includes education, training, and active monitoring of operations. Concerns include:

- Absence of a formal fraud program.
- Although many District leaders and managers have general awareness of fraud risks, there is no one at the District that is fully responsible for fraud prevention.
- Absence of mechanisms to report fraud, such as a fraud hotline, to formally report fraud although the District's CEO maintains an open-door policy for staff to report concerns.
- Absence of independent third-party contract close out audits of large construction projects.
- Absence of formal fraud detection training.
- Absence of independent evaluation of construction contractor bid estimates.

Operational Areas with Moderate Need of Audits or District Monitoring

Business Continuity

Business Continuity Activity Areas	Likelihood	Impact
Business Continuity Plan Management	Moderate	High
Business Impact Analysis	Moderate	Moderate
Disaster Recovery	Moderate	Moderate
Incident Response	Moderate	Moderate

Risk Assessment Results

The risk assessment examined four business continuity activities – business continuity plan development, disaster recovery, incident response, and business impact analysis. Three of the four areas examined had moderate risks that need action or monitoring by the District. Our analysis found that the District began a comprehensive business continuity planning project that led to development of a draft plan. However, the plan has not yet been finished due to staff turnover. In the absence of a formal plan and related testing of the plan, the District does not have assurance of an effective and prompt response should operational disruptions occur. District staff had general awareness of the steps to be implemented in case of operational disruptions, but others raised concern over the adequacy of communication protocols and whether communication devices were fully functional.

Capital Planning and Management

Capital Planning and Management Activity Areas	Likelihood	Impact
Budgeting	High	High
Planning	Moderate	High
Prioritizing	Moderate	High

The risk assessment examined three capital planning and management activities–budgeting, planning, and the process for prioritizing capital project activities. While concerns were found in all areas, one of these areas – capital budgeting – has a high need for an audit. Concerns include:

- The revenue forecasting methodologies used by the District serve to manage cash flow needed for capital improvement project, but District staff reported that revenue forecasts are not fully consistent with the timing of the project.
- Review of capital project cost estimates found unrealistic budgets. The procurement staff who can help District managers with developing cost estimates do not take part in planning meetings.
- District project managers rely on their personal experience in developing budget estimates without consideration of best practices for capital budget development.

The remaining two areas – capital project planning and prioritization – have moderate risk concerning their overall effectiveness. In capital project planning, District staff cited the need to conduct District-wide sharing on efforts to plan and perform public engagement activities for specific projects. In capital planning prioritization, projects with high priority can encounter permitting processes imposed by local, state and federal regulators that can hamper the District's ability to deliver capital projects and can delay project construction for years. District monitoring is needed in these two areas as the District continually improves on its information sharing efforts and works to address regulatory and permitting burdens.

Risk Assessment Results

Financial Management

Financial Management Activity Areas	Likelihood	Impact
AP Administration	Moderate	Moderate
Authorization and Review	Low	Moderate
Automated Reconciliation Monitoring	Low	Low
Billing	Low	Low
Financial Administration	Moderate	Moderate
Financial Performance Effectiveness	Moderate	High
GL Administration	Low	Moderate
Payroll Processing	High	High
Payroll Tax Liability Reporting	Moderate	Moderate
Payroll Review and Reconciliation	High	High

The risk assessment examined 10 areas commonly implemented by government finance departments. The Finance Division implements many standard activities, but moderate and high risks are present in six of 10 areas examined. Although there was noted improvement within the Division since the District's prior 2014 transparency and accountability audit, our analysis found the following:

- The District has not performed a comprehensive examination of its compliance with payroll tax liability reporting, or the accuracy of retirement calculations. Given the District has over 800 employees, risks have occurred in other public agencies about the overpayment of benefits and incurring significant penalties for untimely tax reporting. District monitoring is needed to ensure that controls are in place are working effectively.
- Payroll timesheet reviews are not performed effectively or consistently throughout the District, which impact the financial reporting on projects.
- Accounts payable processing is manually cumbersome, untimely, and needs substantial follow up for some departments by the District's finance staff.

Equal Employment Opportunity

Equal Employment Opportunity Activity Areas	Likelihood	Impact
ADA Compliance	Low	Moderate
Diversity and Inclusion	Low	Low
Grievance Management	Low	Moderate
Workforce Planning	High	High

The risk assessment examined four activity areas applicable to equal employment opportunity (EEO) – American with Disabilities Act (ADA) compliance, diversity and inclusion, grievance management, and workforce planning. Risk levels are mixed across these four areas. The District, overall, implements many suggested activities to accomplish ADA compliance and has had low

levels of grievances filed against District management leading to the "low" likelihood risk scores[1], suggesting that audits are not needed in these areas.

Workforce planning activities, which would identify skillsets needed within each unit and estimate future workloads/staffing needs, pose high risks to the District. Workforce planning activities were limited across the District, and many divisions raised the concern about the complexity of developing a position description and classification that accurately described the work.

In other EEO areas, the District implements many activities to ensure diversity and inclusion, such as establishing different cultural groups. Although each group has its own individual cultural identity, the District sponsors regular pot luck luncheons and mini-cultural events that bring the groups together. Because the risk assessment focused on concerns that could impact operating effectiveness and service/project delivery, we do not believe that audits related to diversity and inclusion would significantly impact these goals.

Performance Management

Performance Management Activity Areas	Likelihood	Impact
Budget Analytics	High	Moderate
Budget Preparation	Moderate	Moderate
Budget Presentation	Low	Moderate
Financial Performance Measurement	High	Moderate

The risk assessment examined four areas of performance management – budget analytics, budget preparation, budget presentation, and financial performance measurement. The District implements many activities across these areas, but key gaps are present in budget analytics activities and financial performance measurement. The District does not assess the cost effectiveness of agency activities. Performance audits can identify District operations that may not spend District resources wisely.

Transparency

Transparency Activity Area	Likelihood	Impact
Transparency	Moderate	Moderate

The risk assessment examined transparency related to the availability of information, information sharing internal and external stakeholders, and conflict of interest activities. In comparison to the District's 2014 transparency and accountability performance audit, the District increased its sharing of public information. For instance, the District has enhanced its website, making it easier to find information. The District's Intranet site also has key information available, but District staff consistently raised concerns about the effectiveness and timeliness of information sharing between

[1]The risk score in one division was high due to potential ADA compliance issues. This area could benefit from management attention. A district-wide audit is not needed because potential ADA compliance issues were limited to one unit.

District divisions and among employees. District managers report that some departments and employees are better than others in giving timely response to internal information requests. Others reported inconsistent information sharing on scheduled public engagement activities. Finally, the District is working on how it manages conflicts of interests and financial disclosures, which are potential auditable areas in the future should newly develop policies and procedures continue to present high risk areas for the District.

Internal Controls

Internal Controls Activity Areas	Likelihood	Impact
Control Activities	Moderate	Moderate
Control Environment	Moderate	Moderate
Information and Communication	Moderate	Moderate
Monitoring	Moderate	Moderate

The risk assessment examined practices for control activities, control environment, information and communication and monitoring. The District, through its efforts of following International Organization for Standardization (ISO) guidance implements sufficient internal control activities but continued monitoring of district activities is needed by District management to ensure that current efforts to streamline business processes and upgrade to new information systems continue to provide adequate accountability.

APPENDIX A: METHODOLOGY

Goal of the Risk Assessment

The goal of an audit risk assessment is to identify inherent and specific risks from operational activities administered by the District Areas found to have a high potential for problems would be recommended for inclusion in an Annual Audit Work Plan. A risk assessment may determine the need for audits across programs, services, or activities that the District recognizes for its exemplary performance. However, a high performing activity may still not mitigate inherent risks to the District.

Scope of the Risk Assessment

Operational activities

The scope of the risk assessment assessed 14 operational activities, as shown in Figure A1.

Figure A1: Activities included in the Risk Assessment

1. Capital Improvement Planning & Budgeting
2. Performance Based Budgeting
3. Financial Management
4. Internal Controls
5. Strategic Goals & Objectives
6. Fraud Prevention
7. Equal Employment Opportunity
8. Purchasing/Contracting
9. Contract Change Order Management
10. Succession Planning
11. Business Continuity Planning
12. Environmental Sustainability
13. Personnel Safety
14. Transparency

Board driven goals

To evaluate whether each of the 14 operational activities could receive help from an audit, TAP International assessed each operational area against three goals, otherwise known as risk factors. These risk factors are:

1. Project Delivery
2. Service Delivery
3. Effectiveness

District entities taking part in the risk assessment

Thirteen District entities took part in the risk assessment, as shown in Figure A2.

Figure A2: District departments included in the Risk Assessment

1. Water Utility Capital Division
2. Water Supply Division
3. Watershed Design & Construction Division -
4. Treated Water Operations & Maintenance Division
5. Watershed Operations & Maintenance Division
6. Office of COO Water Utility
7. Office of the COO Watershed
8. Information Technology Division
9. General Services Division
10. Financial Planning and Management Division
11. Watershed Stewardship and Planning Division
12. Office of District Counsel
13. Human Resources

To select the participating entities for data collection efforts, TAP International analyzed the District's FY 17-18 annual operating and capital budget to identify those entities that comprise 65 percent of the District's total $351 million budget. Figures A3 below shows the results of the selection analysis.

Figure A3: Department Selection Data

Division	Proposed Budget 2017-2018
Water Utility Capital Division	108,513,336
Water Supply Division	87,044,190
Watershed Design & Construction Division	46,649,727
Water Utility Operations & Maintenance Division	29,356,864
Financial Planning and Management Division	28,315,337
Information Technology Division	10,593,957
General Services Division	9,467,408
Watershed Stewardship & Planning Division	7,555,726
Office of COO Water Utility	7,361,540
Watershed Operations &Maintenance Division	5,309,289
Office of COO Watershed	5,117,639
Office of District Counsel	3,234,587
Human Resources Division	3,102,761
Grand Total	**$351,622,361**

District activities were compared against generally accepted government practices and guidance for government operations developed by the Government Financial Officer's Association, U.S. Governmental Accountability Office, IBM Center for Performance, Committee of Sponsoring Organization (COSO), California Institute of Local Government, and National Institute of Technology. TAP International conducted meetings with 32 executives, managers, and supervisors across the 14 operational areas and reviewed relevant District documentation such as prior reports, budget information, annual reports, policies and procedures, and project information.

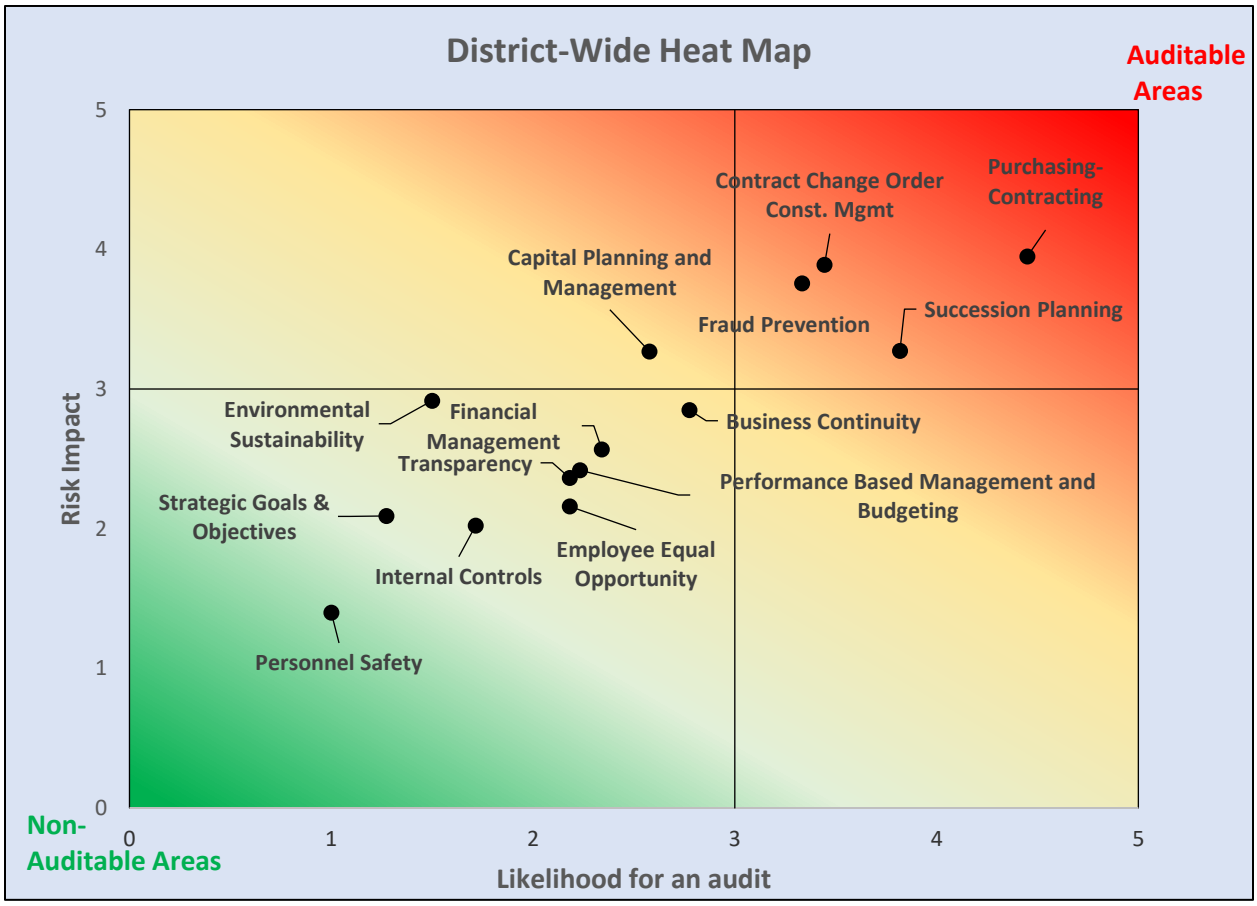
The information collected was assessed and scored to (1) assess the likely occurrence of concerns with project and service delivery and operating effectiveness, and (2) assess the potential impact to the District if potential risks materialized. Table A4 shows the scoring criteria used for the risk assessment.

Table A4: Risk Assessment Scoring Criteria

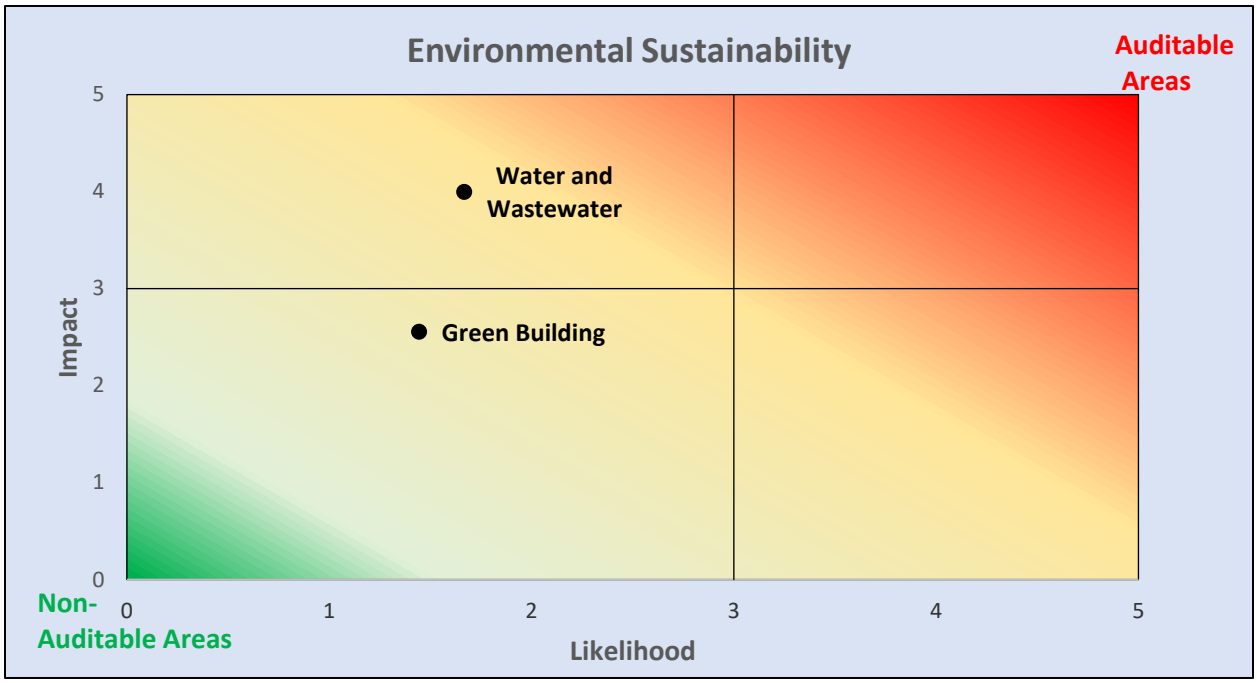
Likelihood for Significant problems in Project and Service Delivery and Operating Effectiveness–	Score
Rare	1
Low	2
Moderate	3
High	4
Almost Certain	5
Impact – Potential reach of Significant Problems	Score
Rare – Little or No Improvement on Any Entity	1
Low – Single Department	2
Moderate – Multiple Departments	3
High – District-Wide	4
Almost Certain – Public and District	5

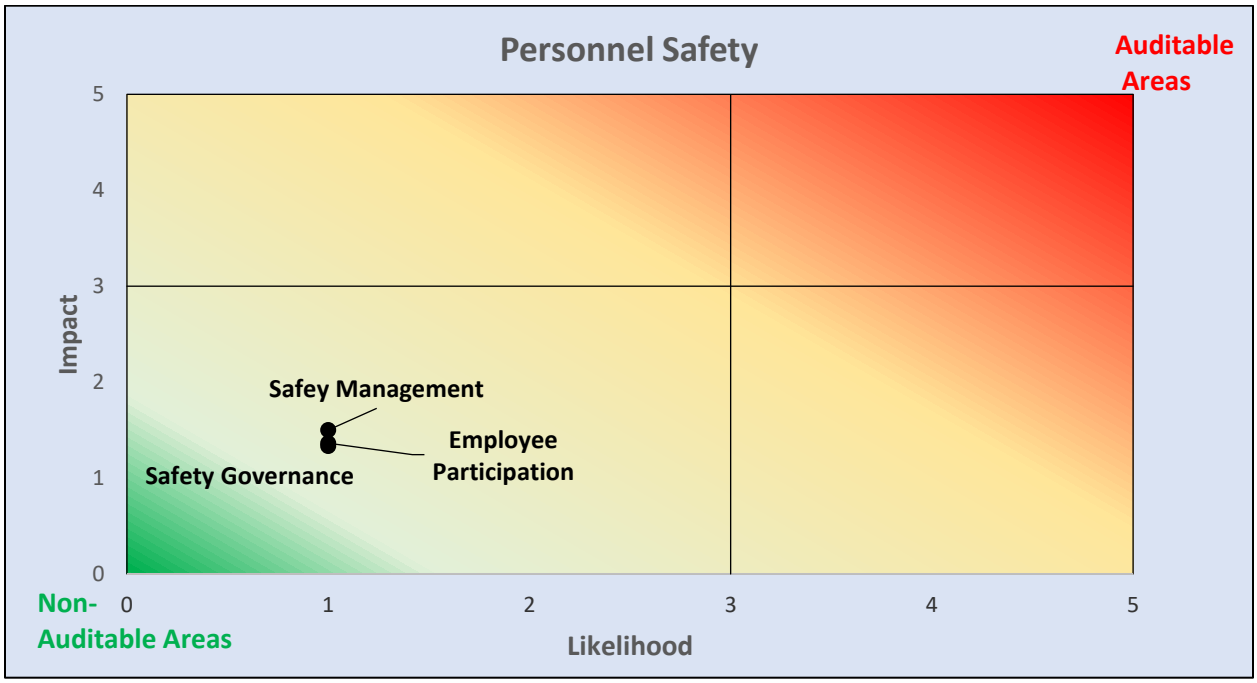
An internal quality review expert later reviewed the analysis for consistency in scoring and accuracy. Finally, TAP International identified those areas within each of the 14 operational activity areas where audits are most likely to find substantial improvement opportunities that could help accomplish the Board's interest in facilitating overall effectiveness, service delivery, and project delivery.

APPENDIX B: HEAT MAP - DISTRICT WIDE

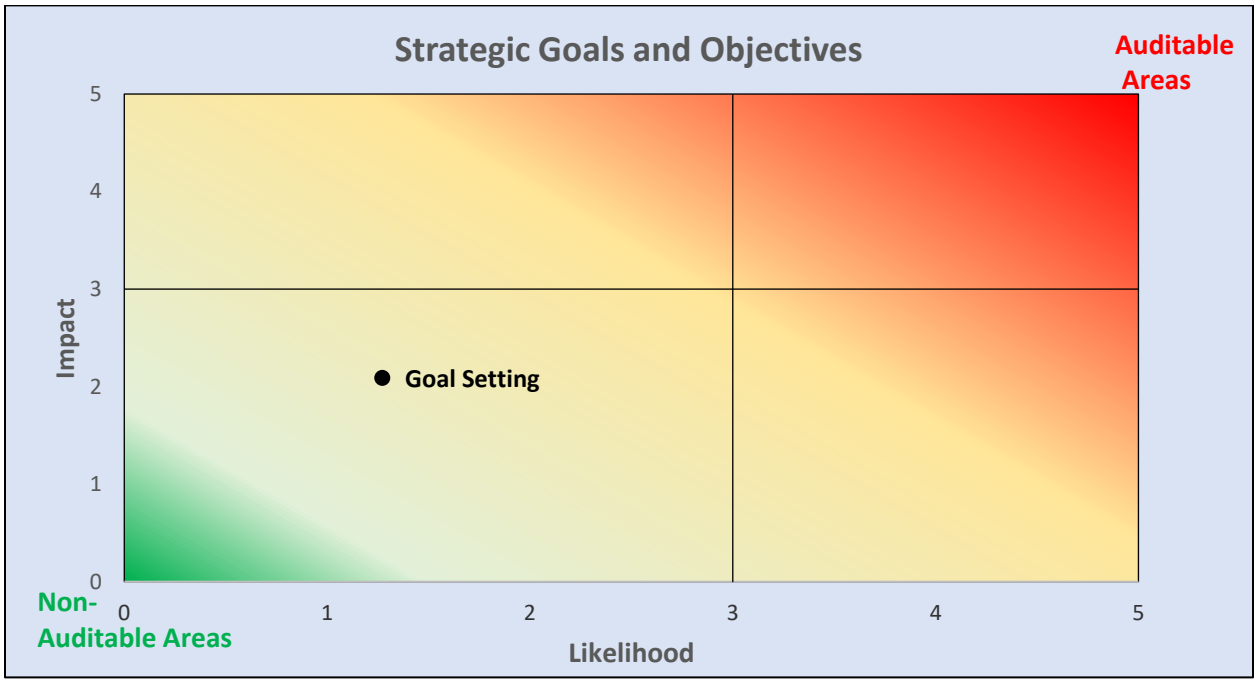


APPENDIX C: HEAT MAPS - Low Audit Risk Areas

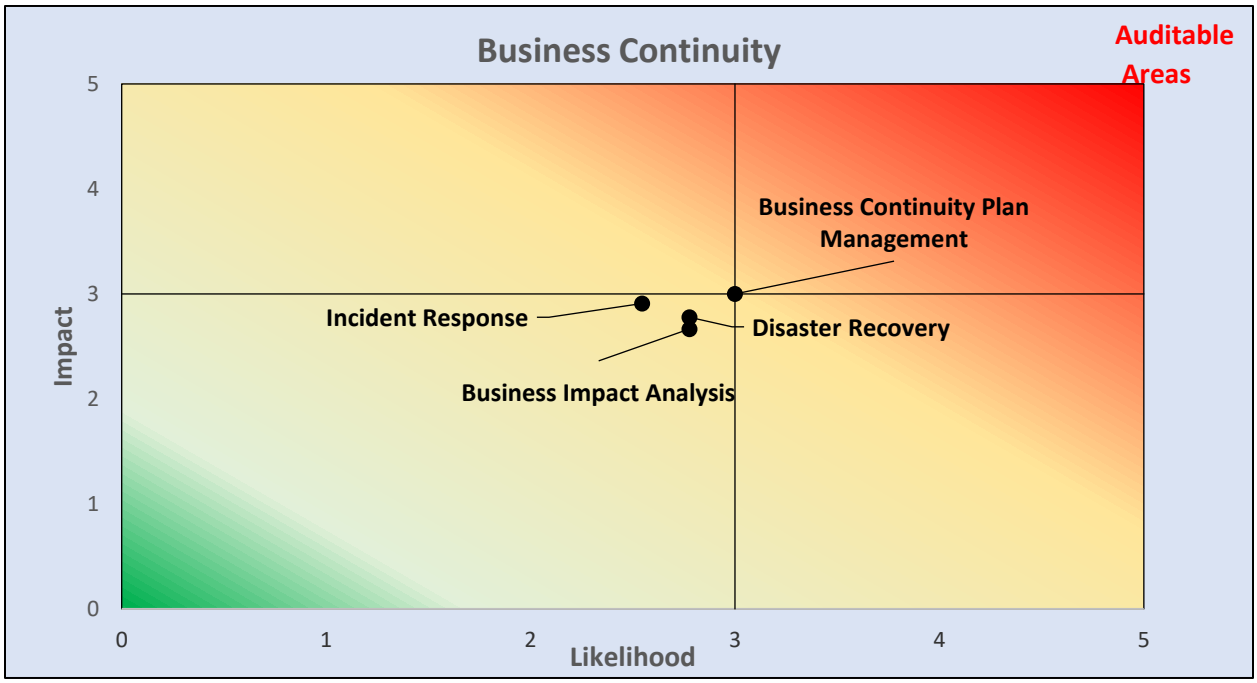


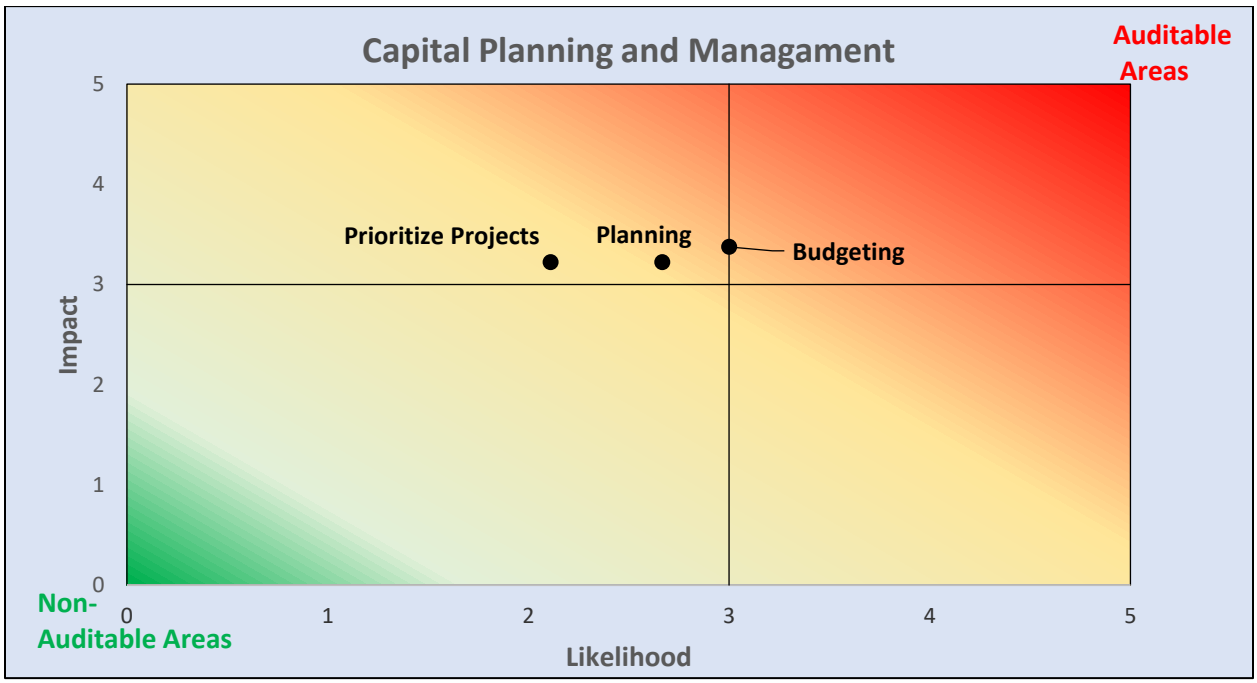


Risk Assessment Results

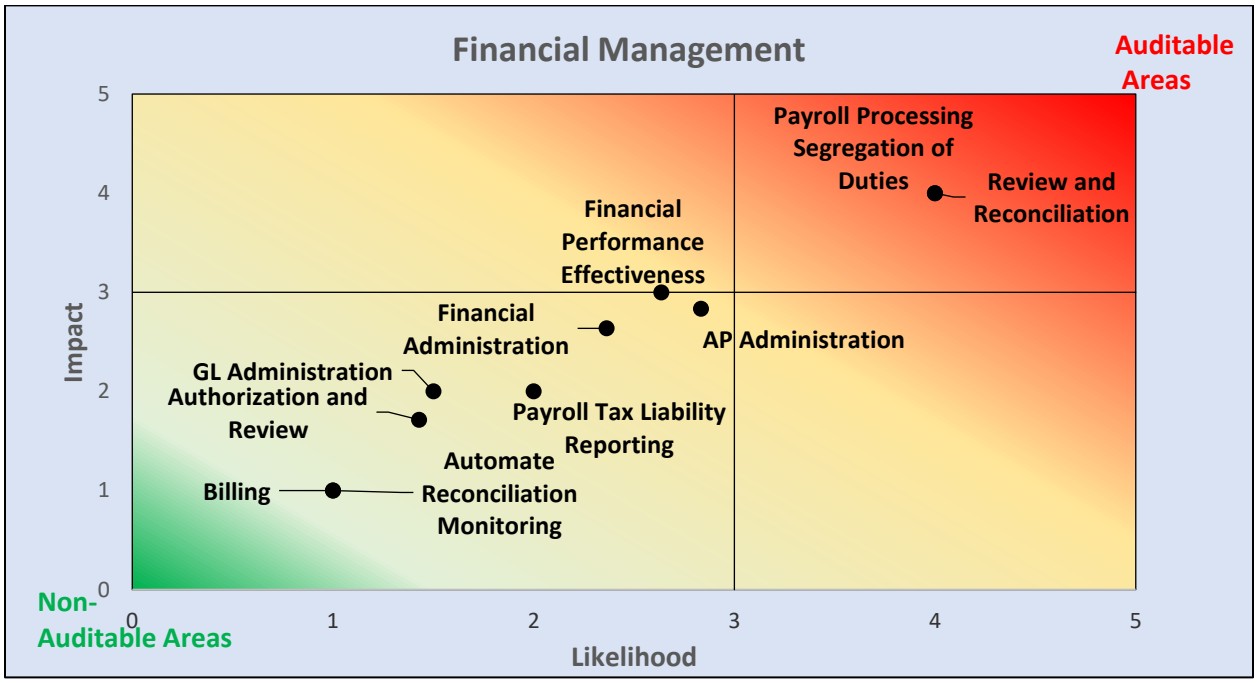


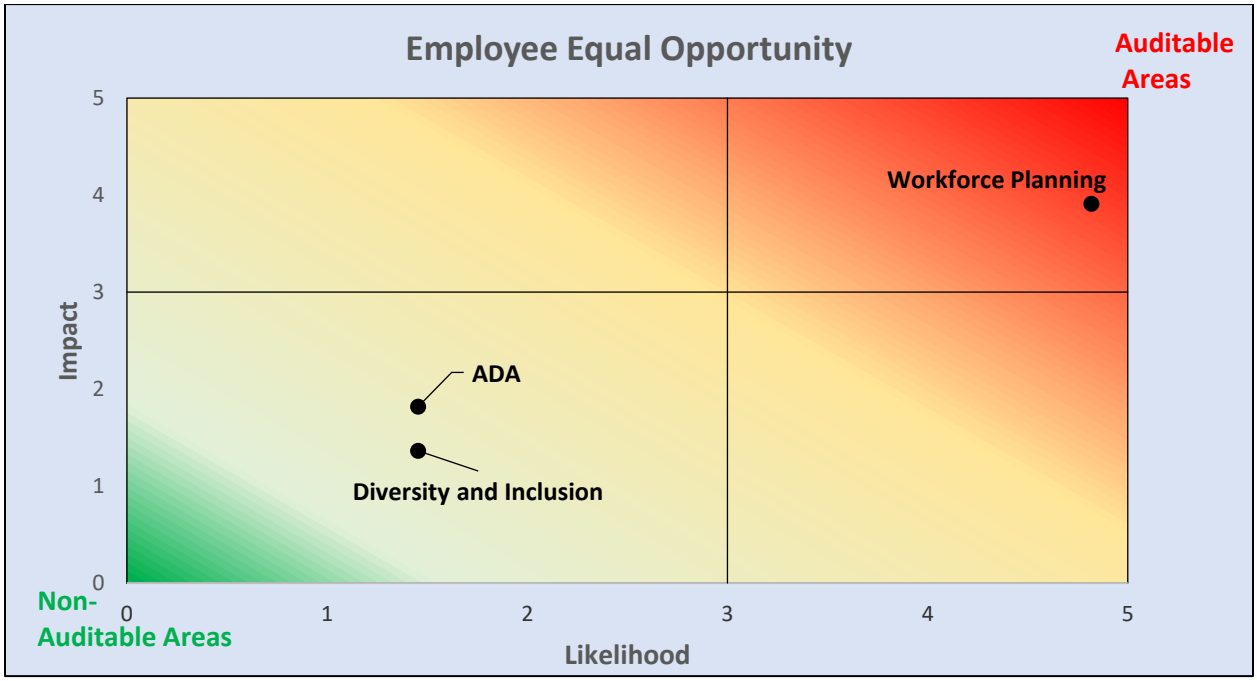
APPENDIX D: HEAT MAPS – Moderate Audit Risk Areas



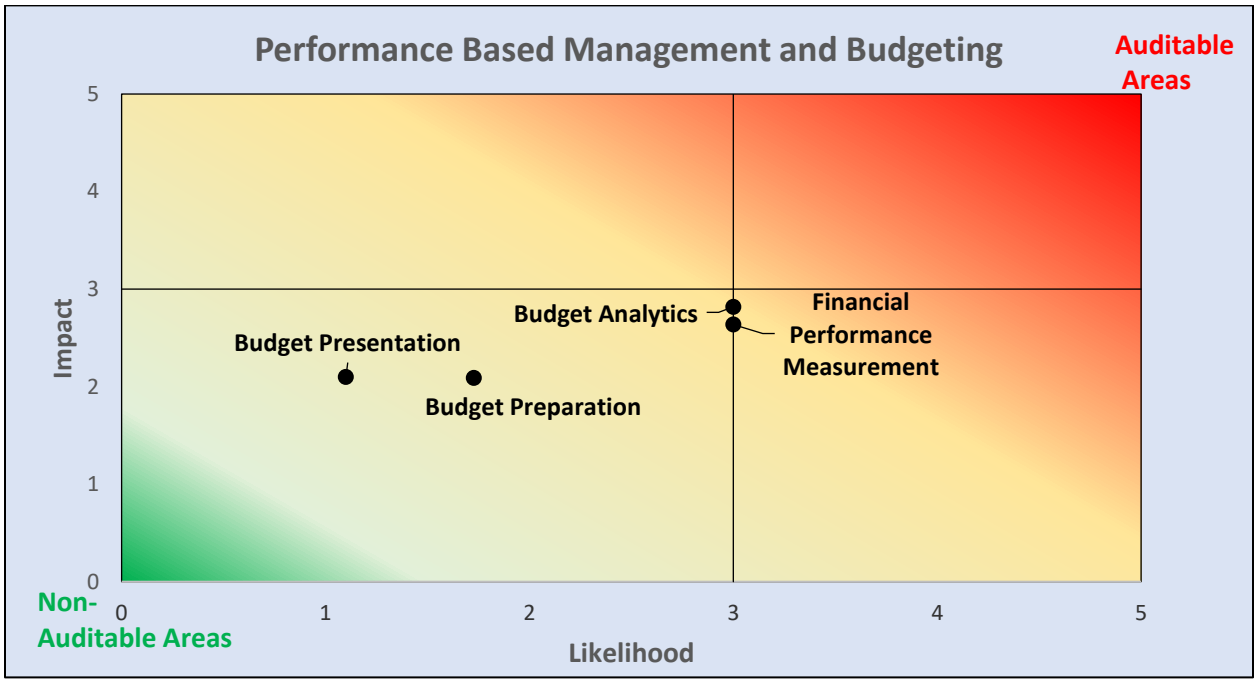


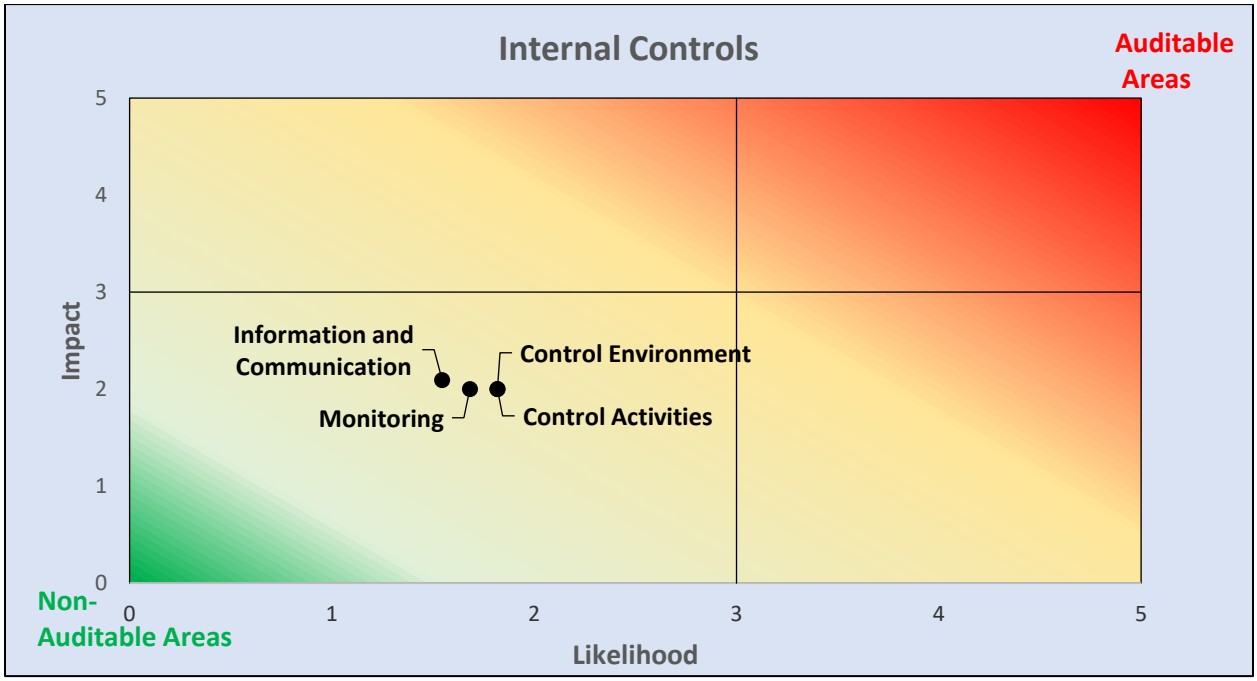
Risk Assessment Results



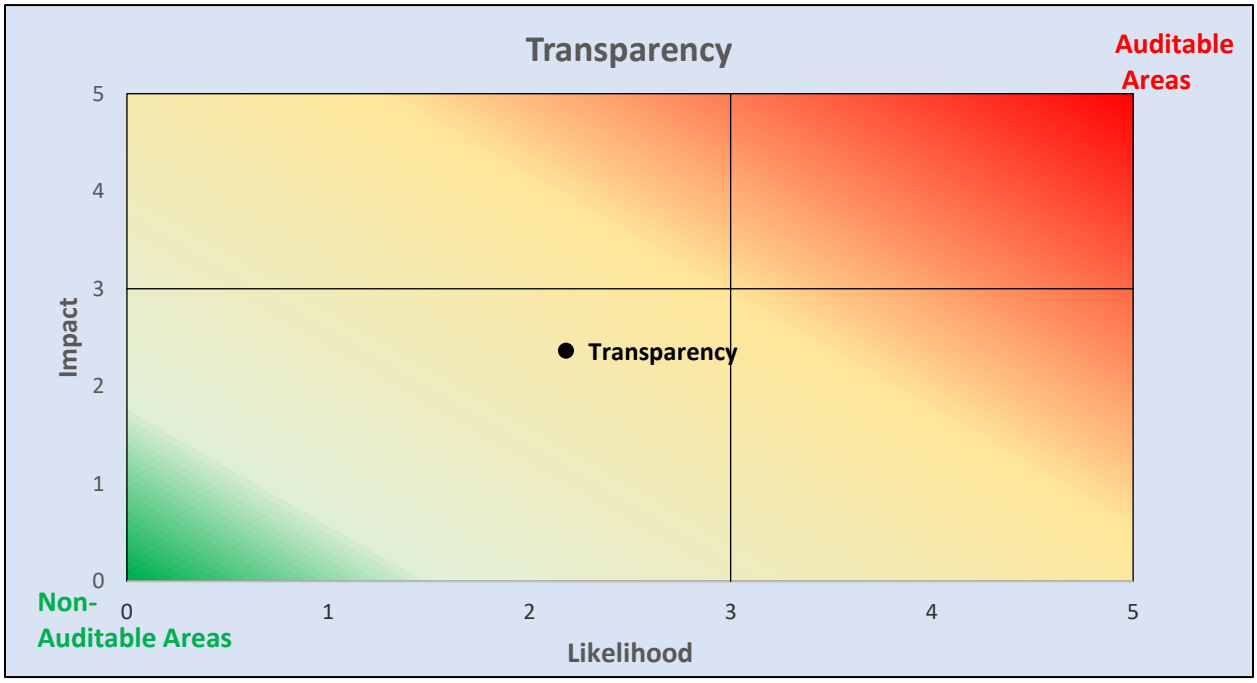


Risk Assessment Results

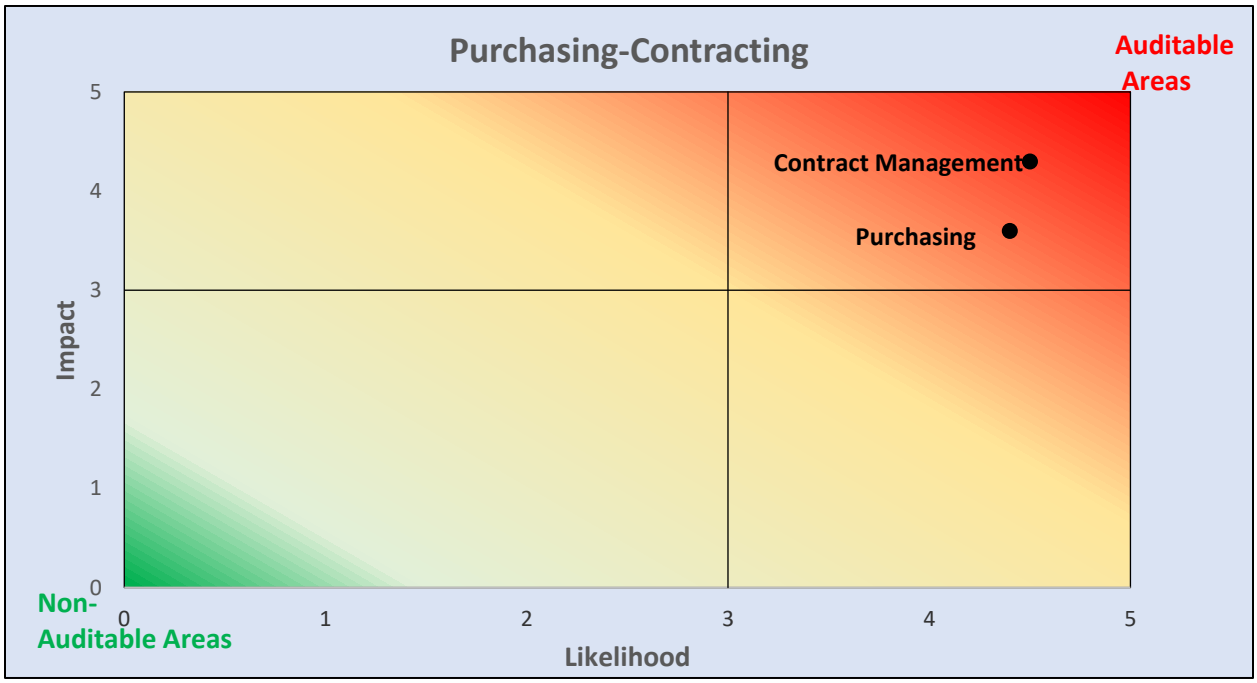


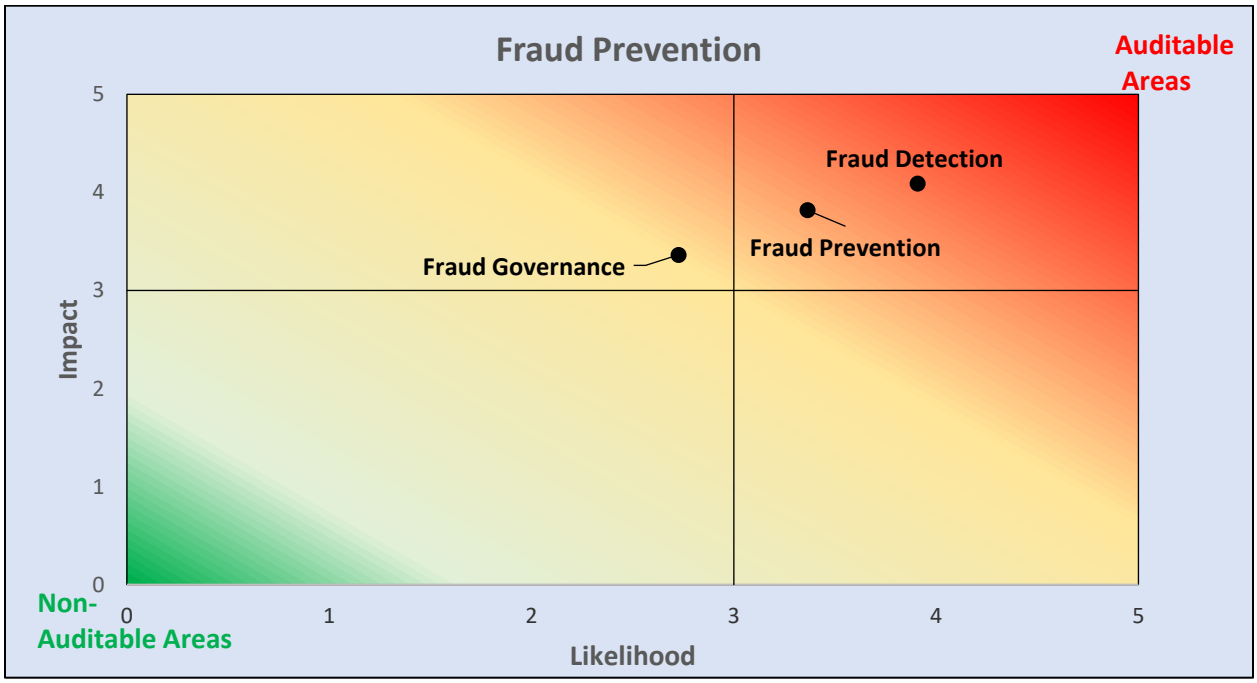
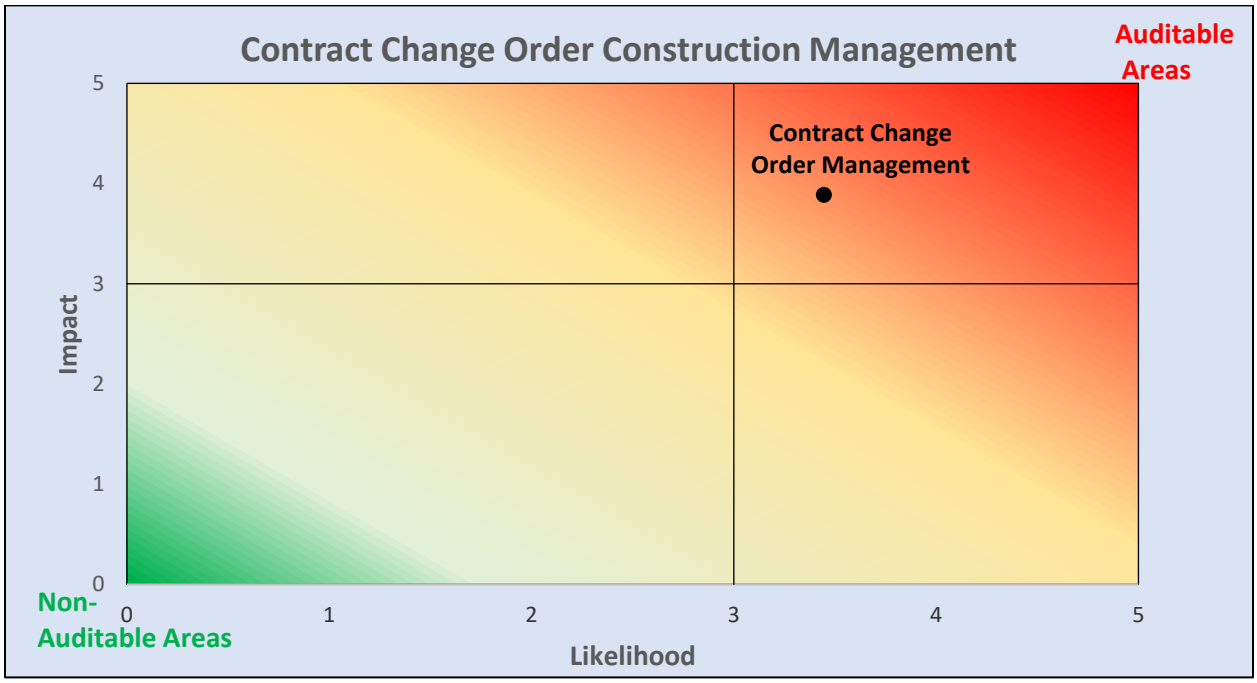
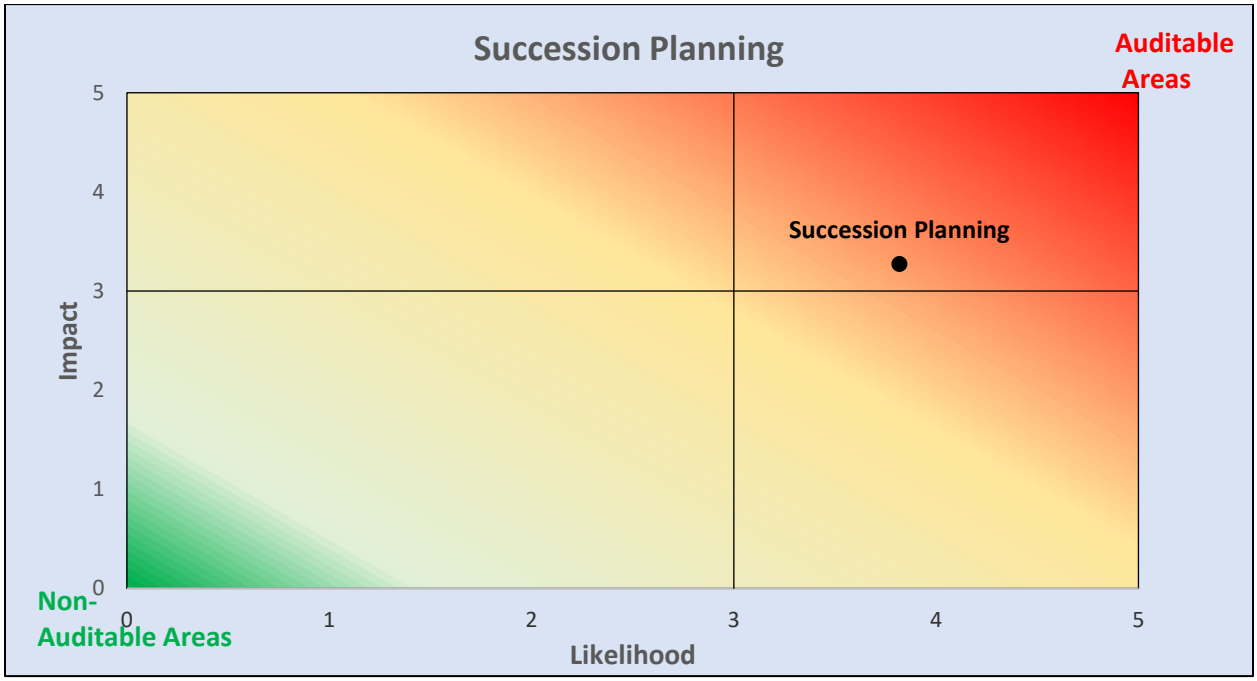


Risk Assessment Results



APPENDIX E: HEAT MAPS – High Audit Risk Areas





Risk Assessment Results